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WMGI - Q2 2017 Wright Medical Group NV Earnings Call

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OVERVIEW:

Co. reported 2Q17 results. Expects 2017 adjusted net sales from continuing operations to be approx. $755-765m and 2H17 adjusted constant-currency revenue growth from continuing operations to be 12-15%.

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Wright Medical Group Second Quarter 2017 Earnings Conference Call. (Operator Instructions) As a reminder, this conference is being recorded. I would now like to hand the floor over to Julie Tracy. Ma'am, please go ahead.

Julie D. Tracy - *Wright Medical Group N.V. - Chief Communications Officer and SVP*

Thank you, and good afternoon, everyone. Welcome to Wright Medical's Second Quarter 2017 Conference Call. We appreciate you joining us.

I'm Julie Tracy, Wright's Chief Communications Officer.

With me on the call today are Bob Palmisano, Wright's President and Chief Executive Officer; and Lance Berry, Wright's Chief Financial Officer.

We issued a press release this afternoon regarding our second quarter results, and a copy of that press release is available on our website at wright.com.

The agenda for this call will include a business update from Bob, a review of our financial results from Lance, a question-and-answer session and then conclude with closing comments from Bob.

Before we begin, I would like to remind you that this call includes forward-looking statements, including statements about our outlook for 2017; our beliefs and expectations regarding the outcome of pending litigation; 2017 cash flow; and new products, including AUGMENT.

Each forward-looking statement contained in this call is subject to risks and uncertainties that could cause actual results to differ materially from those projected in such statements.

Additional information regarding these factors appears in the section entitled Cautionary Note Regarding Forward-looking Statements in the press release we issued today.

More information about risks can be found under the heading Risk Factors in Wright's Annual Report on Form 10-K for the fiscal year ended December 25, 2016, filed by Wright with the SEC on February 23, 2017, as supplemented by our other SEC filings.

Our SEC filings are available at www.sec.gov and on our website at wright.com.

The forward-looking statements in this call speak only as of today, and we undertake no obligation to update or revise any of these statements.

Our earnings release and today's discussion include certain non-GAAP financial measures.

Please refer to the reconciliations, which appear in the tables of today's press release and are otherwise available on our website.

Note further that our Form 8-K filed today provides a detailed narrative that describes our use of such measures.

Unless otherwise noted, today's discussions refer to results from continuing operations. Also note that unless otherwise noted, all growth rates discussed today are on a non-GAAP constant currency basis compared to the prior year quarter.

With that introduction, it is now my pleasure to turn the call over to Bob Palmisano. Bob?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Thanks, Julie, and welcome to our second quarter earnings call. All of our most important financial results are right on track with our plan for the year. We also continue to make significant progress in the second quarter on the initiatives that will enable us to achieve our longer-term goals. I will now provide you with an update on those initiatives and our Q2 financial results.

Highlights in the quarter included outstanding 16% sales growth in U.S. shoulders, driven by strong contributions from the ongoing rollout of our SIMPLICITI shoulder system and the launch of our PERFORM Reversed glenoid, which is off to a terrific start. The 16% Q2 shoulder growth rate is up 3 percentage points from the 13% in Q1, and we anticipate that the launch of our PERFORM Reversed shoulder will drive continued acceleration -- shoulder revenue growth in the second half of the year. We delivered additional instrument sets in late Q2 and plan to deliver additional sets to the U.S. field in the third quarter as well to meet the strong demand we have -- we are seeing for this innovative product.

In our U.S. lower extremity and biologics business, we saw outstanding growth of 32% in our most technologically advanced portions of our portfolio, which include AUGMENT Bone Graft, SALVATION Limb Salvage and Total Ankle Replacement. We also launched the INVISION Total Ankle Revision System at the AOFAS meeting in July. This is an important addition to our total ankle replacement portfolio, which now covers a complete continuum of care. We believe the combination of INVISION, and the recently -- and the significantly improved total ankle reimbursement by CMS that was just finalized today could create a tipping point in the adoption of total ankle replacement.

U.S. total ankle replacement grew 28% in Q2, a full 10 percentage points higher than the 18% growth in Q1. Our U.S. total ankle is now more than $60 million annualized business and continues to deliver very high growth. This supports our belief that we are not far away -- that we are far and away the market leader. We also have a significant opportunity to further -- to penetrate this market, which we believe can grow to be 4x to 5x its current size.

As anticipated, growth in the core U.S. lower extremities, which includes reconstructive plates and screws and our core biologics portfolio, was significantly lower than our more technologically advanced products. This was partially due to the expected revenue dissynergies in the quarter. Going forward, we expect to see improvement in this portion of our business as the 100 sales reps that were added this year have now completed on-boarding and training and have begun to focus on building relationships and ramping up new business in their territories that will benefit us in the second half of the year. I will provide more details shortly on the sales rep expansion.

We had another quarter of outstanding gross margin performance of 78.8%, primarily due to strong growth in our highest-margin products and stable pricing overall. We also had adjusted EBITDA margin expansion of 380 basis points, right on track with our plan for the year. We will continue to focus on improving our balance sheet and our cash flow throughout 2017 and expect to make significant progress on our specific Vital Few initiatives in this area.

Let me now provide some additional color on our business results for the second quarter. First, let's discuss the sales force expansion. As we have said, the key to improving our growth rates in our core lower extremities and core biologics portfolio is our sales force expansion, which we completed in the second quarter, ahead of schedule. We completed the hiring and training of approximately 100 sales representatives in our U.S. lower extremities business in the quarter. We expected to see some -- we expect to see some benefit from these rep adds beginning in the third quarter, a meaningful benefit in the fourth quarter and beyond as the expanded footprint, greater focus on core product portfolio and greater incentives to drive growth begin to take effect.

We have continued to expand our best-in-class foot and ankle product portfolio to meet the needs of orthopedic physicians and patients and further expand our leadership position in the fast-growing lower extremities and biologics markets. In addition to the INVISION Total Ankle Revision System, we also launched our ORTHOLOC 3Di Ankle Fracture Low Profile System and MICA or Minimally-Invasive Foot & Ankle System, at the recent American Orthopedic Foot and Ankle Society meeting. Both of these new product launches were well received by surgeons, and we expect them to further enhance our offering in the foot and ankle market space and allow for improved -- an improved surgical experience.

We also had strong AUGMENT performance in the second quarter, where we had accelerating daily -- average daily revenue as compared to the first quarter. Year-to-date, we have added approximately 370 new customers, of which many of those are brand-new to Wright and customers that were not previously using any Wright products.

In the U.S. upper extremities, our strong 16% growth in shoulders was led by the ongoing launch of the PERFORM Reversed glenoid as well as the expanded BLUEPRINT surgical planning modules that became available during the quarter. Q2 was the first full quarter of the PERFORM Reversed launch, and we are off to a strong start with excellent clinician feedback.

PERFORM Reversed offers our customers a predictable and reproducible reversed system that is designed to address all types of glenoid bone loss challenges. We are enthusiastic about the prospects for PERFORM Reversed, which further demonstrates our commitment to delivering a differentiated product portfolio with the ability to address a broad spectrum of clinical needs in the largest segment within shoulder replacement.

We started to roll out additional instrument sets in the field in late Q2, and we'll continue this in Q3. These additional sets will allow us to more aggressively pursue competitive conversions and drive accelerating growth rates in the second half of the year.

We are also excited about our BLUEPRINT-enabling technology and what it represents for our shoulder business. You will recall that our PROPHECY enabling technology is used in over 70% of our total ankle replacement procedures and has been a key factor in giving surgeons the confidence to perform total ankle replacements and expand their use in their practice. We believe as an enabling technology, BLUEPRINT could have the same kind of positive impact for shoulder surgeons as reduced OR time and improved patient outcomes give them increased confidence to perform a greater number of total shoulder replacements in their practices. Software enhanced-enabling technologies such as PROPHECY and BLUEPRINT are becoming important differentiators between us and our competitors.

Turning now to our other strategic priority in 2017, which is cash. The benefits that we are anticipating in 2017 are largely due to the initiatives that we have been driving over the past couple of years, including improved inventory and instrument utilization and increasing DSO efficiency.

An important initiative that I've discussed before is moving the U.S. upper extremities inventory into our hub network. We continue to make good progress in the second quarter. As of today, we have moved approximately 2/3 of the upper extremities revenue from direct sales districts into the hubs, which is on track with our plans. We plan to complete the remaining direct sales districts by the end of Q4. We believe the hub system is a competitive advantage as it brings us closer to the customer.

We also expect to realize the same significant benefits we saw when we established our hub network and moved our lower extremities inventory into the hubs. These benefits include much more control and visibility over the performance of our field inventory and instrument sets, a reduction in our field inventory days on hand and increasing accuracy of our demand forecasting and much less time spent by our sales reps in inventory management, resulting in improved sales rep productivity. As we said before, this is a significant project, which will take most of 2017 to complete, but we expect this will benefit us significantly in 2018.

In closing, we are building a fundamentally sound growth company that operates in high-growth markets. We have highly differentiated products, enabling technologies and focused sales force. As a result, we believe we will have sustainable mid-teens constant currency net sales growth, gross margins in the high 70% range and non-GAAP adjusted EBITDA margins of approximately 20% in the next 1 to 2 years.

We feel confident about our ability to achieve these objectives and believe we are positioned to perform and positioned to accelerate. The sales rep additions, new product launches and ongoing rollout of AUGMENT, SIMPLICITI and PERFORM Reversed are all on track. The company's very well-positioned strategically, and we continue to make significant progress on profitability and cash.

We are right on track with the key revenue drivers for 2017 and remain confident in our full year revenue guidance of $755 million to $765 million and full year adjusted EBITDA guidance of $78.5 million to $85.5 million.

We continue to expect there will be a strong acceleration in the second half of the year as we annualize the impact of the merger revenue dissynergies and begin to realize the benefits from the expanded U.S. sales force and new product launches.

With that, I will now ask Lance to provide further details on our second quarter results. Lance?

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

Thanks, Bob. As we get started, please note that unless otherwise stated, all of today's discussions regarding our sales growth rates refer to our constant currency growth rates compared to the prior year quarter, and our results of operations refer to our as-adjusted results, which are non-GAAP financial measures as described by Julie during the introduction of our call.

Unless otherwise noted, today's discussions refer to results from continuing operations.

Please refer to the non-GAAP reconciliations in our press release.

Bob covered the highlights of our underlying sales growth in his earlier comments. I will provide some additional color on the P&L and then focus my comments on the outlook for 2017.

Globally, our net sales grew 6%. As anticipated, Q2 growth rates were impacted by the revenue dissynergies, which we estimate were in the range of 2% this quarter and timing of international stocking distributor orders.

The U.S. lower extremity business grew 4.5% in Q2. As Bob discussed, this is the portion of the business that is most impacted by revenue dissynergies, which we estimate were in the range of 2%. We started to annualize the dissynergies in Q2, expect to have most of them annualized in Q3 then have minimal year-over-year impact in Q4.

Overall, we had a nice improvement in the U.S. lower extremities growth rate as the strong acceleration in total ankle growth rates and a reduced headwind from dissynergies resulted in a 4.5 percentage point improvement over the Q1 growth rate.

The U.S. biologics business grew 8% in Q1, in line with our expectations. AUGMENT had a strong quarter with nice improvement in average daily revenue as compared to Q1 while the core biologics portfolio continued to be more challenged. We expect acceleration in our U.S. biologics business in the back half of 2017 through both our sales force expansion initiative in lower extremities and cross-selling programs of core biologics products with our upper extremities sales force that are in place.

The U.S. upper extremities business grew 15% in Q2 due to continued strength of our shoulder portfolio. Q2 was the first full quarter of the PERFORM Reversed launch. We started to roll additional sets out to the field late in Q2 and continue this into Q3. These additional sets will allow us to more aggressively pursue competitive conversions and drive accelerating growth rate in the second half of the year.

As expected, our international business was flat in Q2 due to tough comps from the timing of prior year stocking distributor orders. Excluding the impact of currency, our international business was up in absolute dollars as compared to Q1. As we have discussed in the past, you should expect to see variability in our international growth rates from quarter-to-quarter.

Now moving on to some detail below the sales line. Please note that all of my discussions will refer to our continuing operations results.

Beginning with our Q2 adjusted gross margin, we achieved 78.8% for the quarter, an increase of approximately 30 basis points over the same prior year period. As for the line items making up our Q2 operating expenses, selling, general and administrative expenses as adjusted totaled 71.1% of net sales for the second quarter compared to 73.9% in the prior year period. The decrease as a percent of sales was driven primarily by continued leverage from incremental revenue and cost synergies.

R&D expense as adjusted was $12.4 million in Q2 of '17 and $12 million in Q2 of '16. And finally, amortization expense was approximately $7 million in Q2 2017 compared to $7.5 million in the prior year period.

Below the operating income line, net interest and other expense was $8.6 million for Q2. For share count, our Q2 per share results as adjusted are based on average diluted shares of 104.4 million for Q2. If the company had been in a net income position, average diluted shares for Q2 of 2017 would have been approximately 106.4 million shares.

Altogether, this resulted in adjusted EBITDA of $19.8 million and 11% of net sales for the quarter. From a cash standpoint, our total cash balance, including restricted cash, at the end of Q2 was approximately $378.9 million, which includes $150 million in escrow to fund a portion of the metal-on-metal Master Settlement Agreement. This balance is included as restricted cash on our balance sheet.

I will now discuss our 2017 full year guidance. Consistent with Wright's past practice, please note that our guidance ranges and assumptions for 2017 exclude any consideration for the effect of potential future acquisitions or any other possible material business developments. Additionally, it is important to note we will be using a number of non-GAAP financial measures to describe our outlook for the business. In particular, unless stated otherwise, all of today's discussions regarding our financial guidance refer to our as-adjusted results of continuing operations. Our press release issued today notes those items that are excluded from our as-adjusted results.

As stated in today's press release, we continue to anticipate net sales for the full year 2017 of approximately $755 million to $765 million. This guidance range assumes an approximate 1 percentage point headwind from currency for the full year, which is approximately 1% of cushion as compared to current rates.

In addition, this range implies second half constant currency revenue growth of 12% to 15%, excluding the estimated impact of the 4 extra selling days in Q4 of 2017.

We continue to anticipate full year 2017 non-GAAP adjusted EBITDA from continuing operations of $78.5 million to $85.5 million. We estimate approximately 105.1 million diluted weighted average ordinary shares outstanding for fiscal year 2017. If the company were in a net income position, diluted weighted average ordinary shares outstanding for fiscal year 2017 is estimated to be approximately 107.5 million shares.

Looking at revenue quarterly cadence, from an absolute dollar standpoint, Q3 is typically the lowest quarter of the year. Historically, we have seen around a 5% sequential decline in dollars from Q2 to Q3. And while it is expected to be slightly less than normal this year as the new product launches and rep adds partially offset seasonality, we still expect a decline.

Q4 is always, by far, the largest quarter for the year due to seasonality, and the uptick this year from Q3 to Q4 is expected to be even larger than normal as we have 4 extra selling days in Q4. We expect our Q3 adjusted EBITDA to be the lowest of the year, both in dollars and as a percent of sales. We have stated previously that we expect approximately 300 basis points of EBITDA margin expansion for the full year and that we expect to see roughly that amount of expansion each quarter.

Q2 adjusted EBITDA was slightly more favorable than the 300 basis points of margin expansion, primarily due to the timing of spending. We expect this spending to shift into Q3, which will result in less EBITDA margin expansion than the 300 basis points in the third quarter.

In closing, as anticipated, our Q2 growth rate was lower than our long-term goals as we continue to face the year-over-year headwinds from dissynergies, and we are not yet fully reaping the benefits of our new product launches and sales force expansion. The product launches and rep adds are on or ahead of schedule, and we are confident they will drive significant contributions in the second half of the year. We saw the beginnings of this acceleration in Q2 with improving growth rates in shoulder and total ankle. We are looking forward to strong execution for the rest of 2017 where we will be able to devote our efforts completely to driving our new products, expanding our direct sales forces and improving our business processes. Through the remainder of the year, we intend to build on our lead.

With that, we would now like to open up the call to take your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) And our first question for today comes from the line of Travis Steed from Cantor Fitzgerald.

Travis Lee Steed - *Cantor Fitzgerald & Co., Research Division - Equity Research Analyst*

So revenues came in a couple of million dollars better this quarter than you expected, and I think the Salto divestitures may be taking a little longer than you expected, and currency's a little bit better. Just how should we think about all these moving parts as it relates to your assumptions for the second half? Are your assumptions for the second half of the year changing at all?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

No, that's why the guidance, we reiterated that because we think that's the range we're going to wind up in. There's always some puts and takes as we go through this. I think Q2 was a very positive sign for us. The really important things that we were after really got done, both financially and strategically. We had great growth in our product portfolios that are the leading-edge kinds of products. And certainly in our shoulder business, it was really, really strong. We finished the on-boarding and training of 100 new sales reps that by the end of the year I think should be really producing fairly well, and we launched a number of significant new products. So I think that Q2 was -- the way I look back at it was we really hit on just about everything we tried to do. So there's a lot of moving parts at Wright Medical every quarter, but I think we're in great shape, and I think that's why we feel confident about our guidance that we've given.

Travis Lee Steed - *Cantor Fitzgerald & Co., Research Division - Equity Research Analyst*

Okay. And I have a follow-up. What kind of impact on productivity are you seeing by moving the inventory in the hubs? And how much could this increase in 2018? Is something like $100,000 per rep reasonable?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Well, I don't think we give that out. Well, we had a significant increase when we did it in lower extremity, but there's a lot of factors I mean, it's just not in the hub. It's what products, what the ASPs are, all that kinds of stuff make a big add. But when we did the lower extremity thing, we went from about $600,000 to over $1 million over time, but there are a lot of factors that included that. I'm not going to give you a number, but we do certainly do expect that we will see a pretty good sales force productivity increase as our upper extremity reps, our direct reps will be unburdened from having to move inventory around to meet cases. So this is a big deal for them.

Operator

And our next question comes from the line of Richard Newitter with Leerink Partners.

Richard S. Newitter - *Leerink Partners LLC, Research Division - MD, Medical Supplies and Devices and Senior Analyst*

So I apologize. This might have been asked already. I'm jumping around calls. But just, Bob, if you could talk a little bit about the kind of the rep productivity and what you think is kind of still in store for you out in front. On the lower -- I think you just mentioned something on the upper extremities side. It should get better, but can you give us a sense as to where you are today and where you think that could go longer term? And then I believe you were at about a $1 million to $1.2 million rep productivity in lower extremities, and that's where the bulk of your sales force hires had been in the 1Q. Can you talk a little bit about what we should expect on the rep productivity there?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Yes. There's a kind of a balancing act. I think on the lower extremity side, we are -- before the sales force expansion, are about $1.2 million. We think that, that pushed the envelope a little bit too far, and that's one of the reasons we did the sales force expansion. So we expect that to come down some. On the upper extremities side, once we get all into the hub network, which we expect to have completed by the end of this year, is that we expect that about that $600,000 per rep that we had before the hub movement into the hub took effect will increase. I'm not exactly sure how much. It's a different business. So we'll keep track of it, and we'll let you know but -- so we expect the productivity rate on the lower side to come down as we add more reps. We expect the productivity on the upper side to increase as we complete our transfer of inventory into the hubs.

Richard S. Newitter - *Leerink Partners LLC, Research Division - MD, Medical Supplies and Devices and Senior Analyst*

Okay, great. And then maybe just one follow-up on biologics. Any color that you can give on kind of the AUGMENT growth rate? I think last quarter, you said it was well above the average advanced technology growth rate, which was -- would have implied above 28%. Was that consistent in 2Q?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Yes. I would say the same for Q2.

Richard S. Newitter - *Leerink Partners LLC, Research Division - MD, Medical Supplies and Devices and Senior Analyst*

So faster than 28%?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Yes.

Operator

And our next question comes from the line of Raj Denhoy with Jefferies.

Rajbir Singh Denhoy - *Jefferies LLC, Research Division - MD, Equity Research and Senior Equity Research Analyst*

Wonder if I could just ask a bit on the guidance. You kept the number $755 million to $765 million I think the same, but you lowered the currency exposure, and so essentially, you've taken down your organic growth rate a little bit. Just want to make sure that's, in fact, what you intended to do and maybe what was behind that.

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

Raj, this is Lance. I'll take a stab at that. Really currency has gotten stronger, but we're only halfway through the year. That could change on us. It's just not normal practice for us to do an update on our guidance for currency fluctuations this early in the year. If we get to -- and so really we're just keeping our guidance the same. I mean, it's a very minor change. I think it's about a 1 percentage point change from currency. That's just saying where it is today. So we're not trying to signal anything about our views on the underlying growth of the business. It's really just too early in the year to be changing our overall revenue guidance just because currency looks a little better right now. I mean, it could get worse tomorrow. There's no way for us to predict.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

And also raj, it is a range. So there's -- so as Lance said, it's not changing very much. It's early in the year. So I think we're just -- we feel very comfortable leaving it where it is.

Rajbir Singh Denhoy - *Jefferies LLC, Research Division - MD, Equity Research and Senior Equity Research Analyst*

Right. So there's no message under that? It's just everything is still tracking as you originally described it?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Right.

Rajbir Singh Denhoy - *Jefferies LLC, Research Division - MD, Equity Research and Senior Equity Research Analyst*

Getting back to Rich's question, previous question on sales force productivity. I think one of the questions that's still kind of lingering out there is that these 100 sales reps you hired, how are they ramping in terms of their productivity and how that factors into that sharp acceleration into the fourth quarter. How necessary that is and how it is tracking to sort of meet that ramp you've described.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

The way I look at it, Raj, is that we finished all the on-boarding and training, and we gave everybody their diplomas from the hollowed halls of Wright University, and they're out there working hard. We will see some I think -- to be realistic, we're going to see some -- a little bit of impact in Q3, but I think by the time we get into Q4, that will be more significant. It won't be anywhere where we'll end up next year, but I think it will be a good contributor. And it is part of our thinking in terms of the ramp in Q4 is that we will need to get some contributions from these new reps, and I believe that we will. But we also have other things that are also important for Q4 is that the new products continue on a growth trajectory at a very fast pace. And we also have something that's in the bag actually is that we have 4 extra selling days. So I think all the pieces lead us to be pretty comfortable with that fourth -- Q4 ramp and getting to the range that we've given for the year.

Operator

And our next question comes from the line of Matt Miksic with UBS.

Matthew Stephan Miksic - *UBS Investment Bank, Research Division - Executive Director and Senior Research Analyst*

So I'm going also ask a couple of ramping-type question, too, as we get into the back half. On the glenoid, the Reversed glenoid product, maybe just some color on -- you talked about the sequential acceleration, and you expect -- it sounds like you expect that to continue into the back half. The way this product kind of fits into the practice, is this something that in the first couple of months or the first month that a doctor is using this about as much as he can? Or is this a product that within a doctor's practice, there's training, there's trialing, there's initial use and then there's further acceleration? If you could just give us some color then I have one other follow-up.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Yes, it is a product that I think from my experience with speaking to folks is that once doctors use it, they're committed to it. It's very advanced. It adapts to patients, their bone and their glenoid better than anything else that's out there. And when we first -- when we launched this in Q2, we had a limited number of instrument sets, and we just made this available to current surgeons. In Q3, as we speak, we are rolling out significantly larger number of instrument sets that will enable our organization to go after competitive physicians. And so all this leads to what we think is going to be a very, very strong end of the year in terms of this product and shoulders in general. I mean, we did have 16% growth in Q2, which isn't too shabby, but I do think that the -- when we are able to have the additional instrument sets out in the field is that we should see additional pickup in the Reversed glenoid product that is kind of the thing that's really hot right now.

Matthew Stephan Miksic - *UBS Investment Bank, Research Division - Executive Director and Senior Research Analyst*

That's great. I appreciate the color. And then again, ramping and reps, reps are an area of interest as you can appreciate these 100 new reps. Just maybe some color on -- and you may have covered this, and I -- if you have, I apologize. But sort of level of whether it's noncompetes or the mix of experienced reps versus relatively new reps or reps with relationships. And then also just any color on where do you expect this new group to have its initial success, on the back of certain key products or if there is a focus in that regard, I'd appreciate it.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Okay. About half of the reps were internal promotions. They were people that were covering cases for us. They were what you might call assistant reps. There were not quota-carrying reps. So about 50 of the 100 were homegrown. The other 50 were generally recruited from other orthopedic companies, some not, but generally recruited. It's amazing when I think of Wright years ago, and we had very difficult time recruiting top-notch people into our sales organization. That's really changed dramatically over the last 1 year or 2 years, and that so the reps that we hired from outside are generally speaking, quota-carrying reps from other orthopedic companies that really bought into the concept of being part of a specialized sales force in a very growth market with great products. So they are -- that's the makeup of them. What this allows us to do is now in terms of products is whereas before we do this rep expansion, our organization, and I think it's kind of human nature, our rep organization really gravitated to the high -- advanced technology, high ASP products. That was more interesting to them, and they made more money on that and those kinds of sales. So when we went through the rep expansion, we wanted to make sure that we had the sufficient number of reps that will be able to focus on the core products, the basic products, the screws and bolts and frames and those kinds of things that were kind of getting lost. And competitors, particularly small regional competitors, were coming in and getting those cases. So we added reps. We put a program together that rewards them not just on like a commission basis, but rewards them on growth. And so this mixture we feel will get our core business back on a real strong growth trajectory while, at the same time, servicing our high-tech products that people like anyway. So I hope that answers your question.

Operator

And our next question comes from the line of Jeff Johnson with Robert Baird.

Jeffrey D. Johnson - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Bob, wanted to start with you. I know your business, your product mix, your end markets and that mitigate the risk for you more than probably others in the space that we cover. But just wondering if there's been any change over the last 1 quarter or 2 quarters that you've been seeing relative to 2016 on end market volumes, pricing, payer issues, payer approval rates, things like that.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

We've had stable pricing. That's why our margins are where they are, so no. And I really don't think we've seen anything in terms of volumes -- volume decreases. We've had a -- and as we've gone through this process in our core products, we have lost and gained some customers through that process, and we've had dissynergies that we think are mostly behind us right now. But I don't think anyone is giving me any feedback at all that volumes have, in any way, changed significantly.

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

And, I guess, Jeff, on the payer side, we've actually got some positive news today that the increased reimbursement rates for total ankle from CMS.

Jeffrey D. Johnson - *Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst*

Yes, yes, no. Those were up-coded, I guess, as of today, finalized for that. So yes, that was a good point. Lance, one other question, I guess, for you just as I think about and contemplate the second half guidance. Relative to 2Q on an adjusted basis for 2Q maybe 400, 500, 600 basis points faster in the back half. The last couple quarters you've seen maybe an 8- to 10-point gap between your upper extremities, your lower extremities growth. Obviously, you've got the PERFORM shoulder helping maybe get a little recovery in the core foot and ankle products in that. Does that 8- to 10-point gap between upper and lower extremities, do they both kind of go up in the same rate, and so that gap between the 2 stays similar in the back half of the year? I know you don't guide by product line, but just trying to think how we should think maybe about your upper extremity versus your lower extremity growth in the back half.

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

Yes, I mean, I think maybe not get quite that detailed but -- so we expect both of them to accelerate from where they are, the rep adds really driving improved growth rates and also less dissynergies on the foot and ankle side. And new products, we expect to drive improving growth rates on the upper extremities business. Also, just if you think about the second half, we expect international to do quite a bit better in the second half than it did the first half. It had some tougher comps in the first half, and that's going to help with that overall growth rate as well.

Operator

And our next question comes from the line of Kaila Krum with William Blair.

Kaila Paige Krum - *William Blair & Company L.L.C., Research Division - Research Analyst*

So you guys mentioned that you're doing $60 million now in total ankle revenues. And you just launched INVISION in July. It sounds like you do have a pretty notable tailwind in this business from a reimbursement perspective. And then it also sounds like you're getting a number of new Wright customers via AUGMENT. So, I guess, can you just talk a little bit about how all of those drivers can potentially accelerate the current growth profile within your lower extremities business?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Yes. Those are all positive, and our total ankle growth in Q2 I think was 28%. So -- and it's off a larger number, so that's pretty significant. The thing about the total ankle business is we think that the market is massively underpenetrated, and that we think that the market should be looked at as 4x or 5x what it currently is. And that we have -- if the number's right, and it's today about $100 million market, we have about 60% of that. So -- and I think that should continue because of we have a continuum of care. We have INBONE.

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

INFINITY.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

INFINITY, INVISION and PROPHECY. And whereas I think these are all significant products in their own right but significant when you consider them as a continuum of care. That, combined with the enhanced reimbursement, we think should really drive physicians to do even more. Physicians who are doing total ankle to do more and physicians who are not currently doing total ankles to really entertain the idea of doing them and getting themselves trained and doing them. So we think that should grow. On the other side is that the core product, the core business is a good business. It's not as reliant on innovation as the other parts of the lower extremity business. It's more reliant on almost brute force being there. It's activity-based. It's a real hustle kind of a thing. There's a lot of competition from small regional players and that -- so that was the idea behind really a significant growth in our sales force that we could cover that business as well as cover the more advanced parts of our business. So I think that we did all that so that we would have a growth business that should be double digits in total as we get into next year and the year after. So I think that's all part of our thinking.

Kaila Paige Krum - *William Blair & Company L.L.C., Research Division - Research Analyst*

No, that's all really helpful. And then, I guess, we've been hearing as far as your new reps go that you're hiring again a lot of these guys with a high level of experience, not only in foot and ankle but also with experience in areas like sports medicine. So do you think that there's opportunity to see some pull-through benefit even outside of your core markets driven by those relationships?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Yes. I think we're counting on some of that. It's not a major part of the expansion in why we did it and who we hired. The real thing is that we wanted to be able to service both parts of this -- of our lower extremity business, the core products as well as the advanced products to their full potential. That was really -- that's the driving force behind our organization.

Operator

And our next question comes from the line of Andrew Hanover with JPMorgan.

Andrew Ronald Hanover - *JP Morgan Chase & Co, Research Division - Analyst*

I just want to start out real quick on guidance in terms of what you all are thinking about around the divestiture with OUS Salto. Any updates there?

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

Yes. So as of today, we haven't been notified on that. So we ended up with international Salto for all of Q2, which really at the point in time we're on the call last quarter, we knew that was probably likely to be the case. We still expect to get notified shortly, and we'll just see how it goes from here, but it was definitely in for the full quarter of Q2, and we haven't been notified as of today. I would say from a guidance standpoint, the number's not huge, and there's still expecting to be notified soon. And I would just say that's kind of all contemplated within our range.

Andrew Ronald Hanover - *JP Morgan Chase & Co, Research Division - Analyst*

Okay. And then in terms of the 370 new AUGMENT customers year-to-date, have you started seeing any pull through to the rest of the portfolio in the first half? And I'm assuming these would be easier to convert into the nonadvanced portfolio. So something that we should be thinking about in terms of as you're saying, Bob, the dissynergies, you lost some reps, now you're gaining some reps. So how does that surgeon base sort of stack up now on a net basis?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Yes. We have seen some of it, and we expect more when we have this new sales force fully deployed. So that was one of the things we contemplated with AUGMENT was us having kind of a star product like that, that we would be able to get ourselves in the door with surgeons we hadn't currently done business with. And once we're in the door, hopefully, we'll be able to sell them more. We have seen some of that. We expect to see a lot more.

Operator

And our next question comes from the line of Chris Pasquale with Guggenheim.

Christopher Thomas Pasquale - *Guggenheim Securities, LLC, Research Division - Director and Senior Analyst*

Bob, a question about the international business and just how you're feeling about that segment of the company today. I know there's some lumpiness there due to the timing of orders, but it's generally lagged behind your U.S. operations over the past couple of years. Do you need to invest in either incremental scale or distribution to make that part of your portfolio more competitive?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Well, I don't think investment, additional investment is needed. We have -- it's a Tale of 2 Cities. We have direct markets, and we have distributor markets. And in some of our direct markets where reimbursement is great like the U.K., we're doing terrifically well. In other markets, Germany or France where reimbursement is really poor is the business suffers and is not as profitable. So we're not apt to invest in those. We have made some investments. For example, we now have just recently have a direct organization in Japan, which we think over the next couple of years will pay big benefits. When we had the hip and knee business, we had a very significant business in Japan. And our distributor markets in South America is really a hardware-driven business. And in the Far East, it's a biologics-driven business. And so I think that we will continue to invest where appropriate like we did in Japan. We have a great business in Australia that we've invested a lot in that continues to be a -- to grow and be outstanding. But we have to pick our spots, and so we're not apt to make a lot of investments in markets that can't be too profitable because of the reimbursement. And we will keep our distributor base in those markets until the point where we think we could be profitable by being direct. But it is a business that grows a little bit less than the U.S. in general, and it is a little bit lumpy, and it drives me a little bit crazy because it's hard to predict. But overall, when you look at it over a year, it always does what it's pretty much planned to do and -- but we brought on a new distributor last year in the second quarter in Spain. We had a huge stocking order, so we did great in second quarter of last year. We didn't anniversary that this year. So we just have normal business. So it is a little bit different, and we're patient with it. We think we have made and we'll continue to make investments as long as we get a return on them.

Christopher Thomas Pasquale - *Guggenheim Securities, LLC, Research Division - Director and Senior Analyst*

That's helpful, and then you've talked a lot over the years about the underpenetration of total ankle. It seems like you guys have addressed some of the technological hurdles there, INVISION being the latest piece of that. I'm curious what you think are the biggest obstacles to really expanding that segment today? And is it all about just getting more physicians doing these cases? And maybe along those lines, you could just share how many physicians you're on track to train this year maybe versus next year -- last year, sorry.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Yes, I don't -- I'm not sure I have that number available and how many physicians, Chris. Maybe Julie can give you that later. But the total ankle market is one that we see there's 2 parts of it. There's existing physicians that do procedures, but they still do a lot of fusions on patients that probably are appropriate patients for total ankle. By having the INVISION system, we feel that those physicians will do more total ankles on those patients because without that kind of a bailout, they were concerned that they might run into a problem down the road. So I think this will help them. The bigger avenue, I do believe, are the large number of physicians that do not do total ankles that are doing fusions. And I've been in these kinds of situations before, and I know that what it really takes to have a doctor make this kind of a transition is they have to be fully comfortable with the change. They have to feel confident that the patient that they are operating on is going to have a good result and that they are going to be able to do it. So medical education is a big part of that, and our products are a part of that. We have a big advantage in that we have these enabling technologies, particularly PROPHECY, which helps physicians make that transition and makes them more comfortable. So our -- we have a 2-pronged approach here, and it's working is that we have physicians that are doing some total ankle but not as many as they could be, and that is increasing on a pretty regular basis. We know that, and with INVISION and the increased reimbursement, we think that will drive that. On the other side of that is that, that combined with enhanced medical education and the full product portfolio and PROPHECY helps us gain access to doctors that are open-minded enough to try it, and once they try it, they get to be successful and then they keep on doing it. It's all of that about -- all of that, that's why we made a big bet on total ankle a couple of years ago thinking this was going to be a flagship type of area for us. And we've invested a lot in it, and I've got to tell you we're really happy with the results, and it's really paying off.

Operator

And our next question comes from the line of Joanne Wuensch with BMO Capital Markets.

Joanne Karen Wuensch - *BMO Capital Markets Equity Research - MD and Research Analyst*

Most of mine have been answered. So just briefly, I'd like to clarify something. It sounds as if you have baked in a 1% cushion from foreign exchange. How -- could you repeat or explain a little further how to think about that? And then second of all, I heard you talk about a 20% adjusted EBITDA over the next 1 to 2 years. If my timing is correct, that's a little bit ahead of schedule. Is that the right way to look at it?

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

Yes, Joanne, first of all, on the EBITDA, that's not ahead of schedule. That's right in line with the original 3 to 4 years postclose that we have been saying all along. So that's not a change in timing there. On the currency, we have had -- ever since we gave our guidance in February, we've been clear that our guidance included a 1% cushion at -- for currency at their current rates, and that's still the case. What has happened is rates were a little bit stronger at this point, and so even though we have a 1% cushion, we have a little bit of a benefit that has occurred if those rates were to stay where they are today. We didn't adjust guidance from that. It's just really too early in the year to be moving guidance one way or the other for currency, and we just typically don't do that. We just try and be transparent with you about where things are today. So the 1% cushion is the same as it's always been. It previously was a 2% headwind. Now it's only a 1% headwind, and that's not meant to signal any feelings about the underlying growth of the business. I would just say that's just a movement that's too small to be adjusting our overall guidance for at this point in time in the year.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

So also, Joanne, this is Bob. On the EBITDA, you remember when we did the merger is that we set out a goal of 20% 3 to 4 years postclose, and I think a lot of folks thought that was pretty aggressive thinking how are you going to get there. Well, now we're at about 11% now, and I think we have really good line of sight and are very confident in our ability to meet that goal, which was a pretty audacious goal we think when we made it 2 years ago.

Operator

And our next question comes from the line of Matt Taylor with Barclays.

Matthew Charles Taylor - *Barclays PLC, Research Division - Director*

I wanted to ask a follow-up question on guidance. If I look at the guidance that you gave for the year and the color on Q3, basically would imply a much higher growth rate in Q4 than Q3, and so I just want to make sure A, that's correct? And can you help us kind of bridge that? Is that sales force, sets, products or kind of all 3?

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

Yes, Matt. Some of that depends on how you're looking at it. I mean, it definitely is going to be higher growth rate in Q4 because there's 4 extra selling days. Excluding that, it may be slightly higher because we will be having, obviously, a bigger benefit as Bob talked about from the new rep adds and really PERFORM Reversed should be hitting its stride by then. But the big difference between Q3 and Q4 is the 4 extra selling days.

Matthew Charles Taylor - *Barclays PLC, Research Division - Director*

The organic guidance said 95% Q3 versus Q2. That would imply 10% constant currency growth rates, and then Q4 to get to the middle of your guidance you have to grow organically constant currency about 17%.

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

Yes, Matt, maybe we could follow up offline. I think that what I said was normal seasonality is 5% decline from Q2 to Q3, and it would be less than that this year because the new rep adds and the new product launches would partially offset that seasonality. So maybe that's part of the problem, but maybe we can follow up offline, and you can walk me through more detail exactly the math that you're doing.

Matthew Charles Taylor - *Barclays PLC, Research Division - Director*

Okay, and then on the reimbursement change and with your revision ankle, I'd just love to hear your thoughts as to how quickly you think the market could shift? I mean, I guess, we can all agree that that's pretty positive, but does that start to move things in a month or a quarter? Or does it take a longer period of time, do you think?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Well, it will take effect in October, the way I understand the process. So I don't think that it'll have much of an effect in the remainder of this year, maybe some, but not much, but I do think that as we go on, this will have a pretty important effect throughout 2018 and beyond. It's just -- doctors have often said they were doing these total ankles, and it took them so much longer, and they were getting reimbursed under the DRG, and it didn't make any sense to them. And so we really took the initiative as a company and people, a shout-out to our group here that did a great job working with the Society to get this increased reimbursement. This is significant. This is $7,000 per procedure. Now that goes to the institution. But generally speaking, institutions share some of that with the physicians that will -- so that they will benefit from that also.

Operator

And our next question comes from the line of Glenn Novarro with RBC Capital Markets.

Glenn John Novarro - *RBC Capital Markets, LLC, Research Division - Analyst*

Bob, based on the data you published, AUGMENT improved sequentially from May to June. Can you provide any color as to why AUGMENT picked up in June? Did you open more accounts? Maybe just some color based on what we saw (inaudible) published data.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Glenn, we were increasing throughout the quarter, but I'm sure that in June, there were more -- it's also a 5-week month as opposed to May, and we also had some improvements in some of our international businesses in AUGMENT. So I think that when you're looking at the published numbers is you have to take into consideration it's not just a U.S. number, it's a worldwide number in that. So -- but I do want to say is that I think AUGMENT's on a great trajectory, and it is -- it still has a lot of potential penetration out there that we would like to get and will get. But it's on a great trajectory, and we ended Q2, it was really a very, very strong performance in AUGMENT.

Glenn John Novarro - *RBC Capital Markets, LLC, Research Division - Analyst*

Okay. And then quickly just a follow-up for Lance. You mentioned that there were some spending in 2Q that didn't occur that will fall into 3Q. Can you provide some color as to what this spending is, what is it behind?

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

Yes, no details on that. It's just a lot easier to get your spending right over the course of the year. Sometimes things move from quarter-to-quarter, and so there's nothing specifically to highlight out of that. And we expect by the end of Q3 at a year-to-date standpoint, we'll be right on track with what we originally expected.

Operator

And our next question comes from the line of Matthew O'Brien with Piper Jaffray.

Matthew Oliver O'Brien - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

Just on the shoulder performance in the U.S. was quite strong again. You're almost doubling the overall market growth rate there. So I'd love to hear a little bit about the dynamics that you're seeing in there. With one of your competitors mentioning that they were doing well competitively this quarter, one of them that's likely distracted with some leadership changes, how are you -- how much are you benefiting from that distraction, volumes, new product flow? I mean, what's really driving that performance? And how sustainable is it?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Well, yes, I mean, I think we are growing about double the market. So we're taking share from somebody. I suspect the normal suspects, I think, that we're taking share from. But the other part of that is we had a -- we had some significant -- we saw really significant product differentiation. The SIMPLICITI product, still there's no one else out there with a stemless product. We keep on saying we expect someone to be out there with one, and we continue, and I believe that we will, but each quarter that we don't -- that no one has one, that's good for us, and we get further entrenched with our customers and as well as being able to get new customers. This PERFORM Reversed glenoid is really a big deal, and it was a kind of a one area that we didn't have the product that we really wanted, and we were able to launch it really ahead of schedule. We increased our forecast internally on that and therefore, had turned up the volume of kit manufacturing and set manufacturing because there's such a strong demand for that. And then also the third part of this is, had some effect in Q2, but I think is going to be a dramatic effect in our shoulder business in the years ahead, and that's the BLUEPRINT software. Having software-enabled technology is just terrific. It helps preoperative planning. It has the potential of reducing time in surgery. It has the potential also to have better outcomes because of the detailed planning that goes into it. And selfishly for us, it most likely will result in us having to have less inventory because you're just bringing in what you need. So those are all big positive things in our upper extremities business and our shoulder business.

Matthew Oliver O'Brien - *Piper Jaffray Companies, Research Division - MD and Senior Research Analyst*

That's helpful. And then just as follow-up, with respect to INVISION, you have a lot of customers at this point on the lower side of the house. How should we think about that product rolling out over the next couple of quarters and the impact it could have in Q4 specifically given your large presence already with a lot of these docs?

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

We've always said that this product in and of itself is not going to be huge, but it does give us the ability to -- for doctors to do more procedures, procedures that they might not have done a total ankle on, but given that they have this INVISION product that if they need it down the road is available to them. And secondly is that also is that physicians, that surgeons that are not doing total ankles today will give them -- get them more comfortable with the concept of doing total ankles. So it will be better for their patients. But in and of itself, this is not -- we don't expect huge dollars from the INVISION product. We expect the INVISION product to help grow the total ankle business in general.

Operator

And our next question comes from the line of Larry Biegelsen with Wells Fargo.

Lawrence H. Biegelsen - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Bob, one on the sports medicine business, one on the long-term goals. So back on the sports medicine business, Bob, what's the strategic vision for that business? Is it -- you haven't been shy about divesting noncore businesses, and this is one that is growing below the rest of the company, and I had one follow-up.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Yes. We have not invested in the sports medicine business. We have so many other avenues that are more -- seem more important to us with higher potential than the sports medicine business. So I would say that we, at present, do not have plans to divest it, but we're not investing in this business either. There are good products in there, products that are used in some of our other areas of our business that are important to us, but it's not a strategic imperative for us to invest in, in sports medicine, Larry.

Lance A. Berry - *Wright Medical Group N.V. - CFO and SVP*

Larry, it's really small. Sports med and other is about a $20 million of revenue, and that's not all sports med. It's sports med and others. So it's not great that it's lagged the total, but it is really small.

Lawrence H. Biegelsen - *Wells Fargo Securities, LLC, Research Division - Senior Analyst*

Got it. And then on the long-term goals, maybe some of the confusion from one of the earlier questions was the language was a little different about the 1 -- next 1 to 2 years, and I wanted to focus my question on the top line goal of a mid-teens growth rate because at the time of the acquisition or when you did the Tornier deal, you said you would expect it to grow at a mid-teens rate after the integration at which implies 2018 because I think the integration should be done in 2017. And in fact, the guidance for the second half of this year is almost a mid-teens rate. So I just wanted to make sure nothing had changed because the press release says next 1 to 2 years, and I would think that based on the prior comments, we should expect 2018 to be mid-teens growth for Wright. So hopefully, I'm not parsing things out too much but just wanted to make sure nothing's changed.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

No, thanks, Larry. No, the 1 to 2 years, we were talking about EBITDA of 20%, which when we originally did the merger is that we said 3 to 4 years postclose, which now we're 2 years into it, is now it's 1 to 2 years, and we are right on schedule to do that. The EBITDA number. Regarding the mid-teens growth is that we would think that as we get into 2018 and beyond, we should be that type of a company. We should be a mid-teens growth company.

Operator

And that concludes our question-and-answer session for today. I'd like to turn the floor back over to Bob Palmisano for closing comments.

Robert J. Palmisano - *Wright Medical Group N.V. - CEO, President and Executive Director*

Thank you, operator, and thank you all of you for joining us today. We have multiple opportunities through our robust new product pipeline to further accelerate our growth, continue to expand our markets and gain market share. I believe we are well positioned to continue to accelerate our business momentum and drive market-leading growth and profitability. I want to express my appreciation to our team for their efforts in Q2. I look forward to updating you on our next quarter earnings call. We appreciate your interest and your continued support. This concludes our call.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program, and you may now disconnect. Everyone, have a great day.